Commercial Best Practices

THE UNIVERSITY of TENNESSEE
CENTER for EXECUTIVE EDUCATION

DAU Acquisition Community Symposium
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Vested Outsourcing is based on research by…

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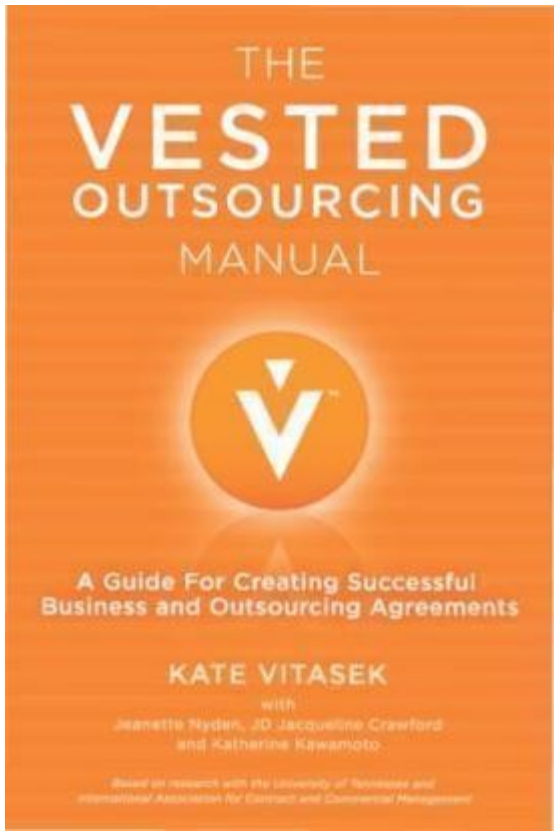

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AGENDA

- Market Intelligence
- Governance
- Incentives
- Supplier Relationship Management

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Market Intelligence

A thorough understanding of the marketplace, and the innovations that are driving down costs and increasing service levels

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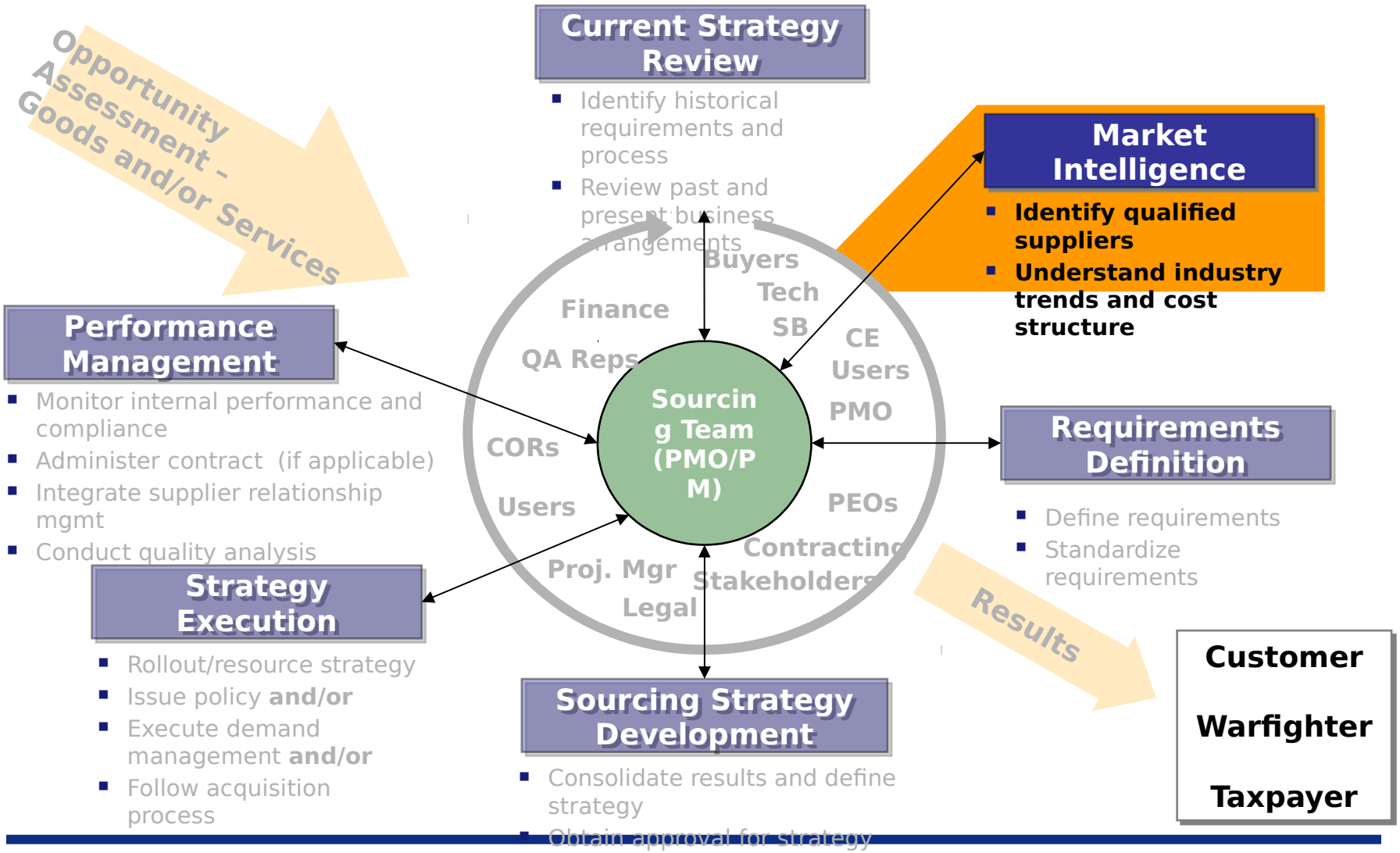
Air Force Sourcing Model



Defining Market Intelligence

- "Market Research" is the process of collecting and analyzing information about capabilities within the market to satisfy agency needs (FAR 2.101)
- Market Intelligence is a more robust version of Market Research that goes beyond the traditional “check the box” process – a true understanding of all alternatives available across the marketplace

Market Intelligence provides the foundation for a successful sourcing strategy

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Key Elements Of Success In Market Intelligence

- Start early
- Involve users
- Communicate as a team
- Think of market intelligence as an iterative process
- Tailor the investigation
- Refine as you proceed
- Document the findings as you go

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Myth-Busting

- A memo was published on Feb 2, 2011 by Daniel I. Gordon, Administrator for Federal Procurement Policy
- Subject: ***"Myth-Busting": Addressing Misconceptions to Improve Communication with Industry during the Acquisition Process***
- Bottom Line:
  - Government officials can generally meet one-on-one with potential offerors as long as no vendor receives preferential treatment.
  - Disclosure is required only in certain circumstances, such as for meetings with registered lobbyists. Many contractors do not fall into this category, and even when disclosure is required, it is normally a minimal burden that should not prevent a useful meeting from taking place.

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Determine Information Required

- What information will be helpful for the project
- What are the key drivers of the Desired Outcomes?
- How will the decision be made?
- How important is cost?
  - What are the cost drivers?
- How important is quality?
  - What drives quality?
- Does any of the information gathered so far show wide variation?
  - That is, how can the interviews be used to reconcile disparate data and opinions

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Determine Questions To Ask

- Start by looking at key topic areas and mapping them to groups of individuals to interview
  - What information does each group have?
  - What are the three to five key questions to ask
- Format of the questions
  - Open ended
    - Yes / no questions don't encourage discussion
  - No opinion / leading questions
    - "Would you agree that……"
    - "Isn't it true that…"
  - Work to be neutral during the interview

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And If You Cannot Go To Them…?

- Meet with potential suppliers 1:1 when they attend Industry Day
  - Keep your questions open-ended
  - What new solutions are available?

- Adapt your Interview Guide to an RFI format
  - Include questions designed to broaden your horizons

- Conduct a Survey – effectively a targeted RFI
  - Post your RFI on FedBizOps, as usual
  - In addition, develop a "mailing list" of the companies from whom you would really like to gain insights
  - Individual emails, asking them to participate in your survey
    - Appeal to their patriotism!

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Market Intel Interview Questionnaire
463L Pallet Team

U.S. AIR FORCE

- What is your experience (in fabricating/repairing large aluminum components)?
- Please describe your manufacturing process
  - How do you mange material?
    - How do you manage aluminum (availability, lead time, on-time delivery, cost)?
  - How do you control quality?
    - What information do you collect on defects?
    - What are you doing to reduce defect/improve yield
- Who are your major suppliers?
  - How do you manage them to ensure timeliness? Quality?
- What are your major cost drivers?
  - Where is your facility located? How does this affect cost (labor, transportation, utilities, etc)?
  - How important is a qualified/skilled workforce to your processes?
    - Please explain?

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EXAMPLE

Market Intel Interview Questionnaire
463L Pallet Team (continued)

- What is your output capability monthly? Can you surge and what is the maximum output you can produce? How long will it take to get to full output capacity?
- What are your limiting factors?
- How do you manage your metals, both acquisition process and recovery?
- How do you reduce costs?
- What data collection capability do you have at the work center? What reports do you generate?
- What new innovations have you entered into your product line ? Could we use it in our product? What new innovations have you entered or into your production capability?
- Do you have any transport agreements that would benefit the movement of pallets?
- Describe how you would provide pricing opportunities for depot worldwide? How would you accomplish this?

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EXAMPLE

Governance

A well defined governance structure for managing innovation in performance based agreements

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Microsoft One-Finance
Background

- In February 2007, Microsoft signed a 7 year, $185M agreement with Accenture to manage their back office finance processes across 95 countries, spanning three major areas:
  - AP - Expense reports & invoices
  - Requisition to Purchase Order process
  - General accounting
- Under the agreement both parties are incented to improve performance and deliver increased value – and share in the risks and rewards of doing so
- 28 months later they extended the agreement to 2018, at a total contract value of $278M, and a few months later expanded the scope to include Accounts Payable and Buy Center processes for the US increasing the contract value to $330M
- In addition, Accenture has an opportunity to work on transformational projects with Microsoft, thereby adding value for both parties

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Microsoft One-Finance

Value-Share Model for Transformational Projects

- All transformational projects have detailed business cases reviewed through the governance structure specifically created for managing the transformation program
- The business case captures the total benefits (i.e., size of the pie) that would be generated through the project and the total cost to be incurred to implement the project and get it operational
- Accenture takes responsibility for implementing the entire project, except for activity that specifically falls within the purview of Microsoft (for example, technology interface)

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Microsoft One-Finance
Value-Share Model (continued)

- Based on this, Accenture's share of benefits is computed to include:
  - Implementation cost
  - Compensation for profit margin on the revenue lost due to the implementation of the project
  - Transformation incentive.

Value-share Model	
Total Savings from Project	TS
Cost of Implementation	(A)
Compensation of lost margin	(B) = X% of TS
Transformation Incentive	(C) = Y% of [(A) + (B)]
Accenture share of Benefits	(D) = (A) + (B) + (C)
Microsoft Share of Benefits	MS = TS – (D)

- Microsoft was able to do 11 transformation projects that have resulted in over $30M in savings in the first 2 years

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Results After 3 Years

- 11 Transformation projects generating over $30m in savings
- 20% cost of contract reduction after 2 years
- Reduced the number of systems used to manage Microsoft's finance operations from 140 to less than 40
- Out of 2,100 total Accenture SLA instances, Accenture has missed 9, or a miss rate of only 0.43%.
- Satisfaction levels amongst Finance Operations' customers (Finance and Procurement community) has substantially increased over the past three years. Whilst the overall satisfaction increased, the proportion of customers either "Dissatisfied" or "Strongly Dissatisfied" moved from 33.30% in 2008 to 3.4% in 2009.
- SOX compliance from just 15 "large" countries in the pre-Accenture to all 92 countries irrespective of size or complexity
- Winner of the Shared Services Outsource Network "Best Mature Outsource Services Delivery" award for 2010

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Incentives

Fee At Risk

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The Basics of Fee At Risk

- Most often applied to Cost Plus contracts, but can work with FFP
- Total contracted costs are made up of:
  - Actual labor and material costs to perform the work
  - Management and overhead costs
  - Profit
- The contractor places part or all of the profit at risk against meeting / exceeding specific mutually defined performance goals

- This allows the business (or the government) to budget for the total fee to be paid, but to pay it only when the work meets the goals

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Facility Management #1
Background

- OutSourceCo identified several procurement goals for the 92-building, 10M square-foot portfolio, including:
  - Leverage purchasing volume to reduce initial costs and lock downstream costs
  - Increase service quality and consistency in processes and practices
  - Benchmark costs and services and improve resource sharing
  - Allow localization of service level agreements by site to meet customer needs and differing site objectives
- Overall ProviderCo's scope spans 57 different services, including:
  - Core facilities management services
  - Managing over $200M in materials purchases
  - Payments to third parties for services
  - Payment and tracking of utilities
  - Pass through of direct labor and direct management over a wide variety of services

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Facility Management #1
Fixed Management Fee – Portion At Risk

- The current Integrated Facilities Management (IFM) Agreement provides for a fixed management fee PSF for portfolio square footages above 13 Million Square Feet (MSF)
  - Fixed fee PSF allows for flexibility
  - 13 MSF provided a minimum floor for the ProviderCo to allow comfort in investing in a base management team
- The management fee is comprised of two components
  - The Base Component that comprises 64% of the total, and
  - The At-Risk Performance Fee Component representing 36%, based on ProviderCo's ability to meet contract performance expectations based on scorecard ratings achieved
  - The performance fee is based on four quarterly scorecard ratings and paid out quarterly

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Facility Management #1
Cost Driven Incentives

- A Shared Savings incentive based on 25% of the first 12 months savings of demonstrated cost reduction results.
  - Shared savings is capped at a predetermined PSF maximum
  - Typically setting caps on incentives is less desirable – the use of a “gain-share” incentive structure in the agreement does promotes “skin in the game” to drive transformational behaviors.
- A Commitment Based incentive fee – also based on a PSF maximum
  - Also funded from cost reductions, the second 25% funds the ‘commitment based’ incentive fee, based on achieving specified commitments – usually involving certain projects

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Facility Management #1

	Pricing Model Framework					
	Base Business / Service Delivery				Transformational	
	Contract Type	Management Fee			Shared Savings	Performance Goals
		Base	At Risk	Governance		
Model	Base Book: Cost plus incentives	64% Base	36% At Risk	Included in base fee	Funded by the 1st 25% of demonstrated savings	Funded by the 2nd 25% of demonstrated savings
	Projects: Cost plus incentives	64% Base	36% At Risk	Included in base fee	Defined by project budget	Defined by project goals
Caps or Adjustments	None	36% at risk based on performance			Capped @ additional 36% of Base Book	Capped @ additional 9% of Base Book
Payout	None	Paid Quarterly Based on Performance			Annually Based on Savings	Annually Based on Performance
Percent of Total Provider fee	0%	69%			25%	6%

Facility Management #2
Background

- OutSourceCo identified facilities management as a non-core activity that could be improved and made more efficient
- OutSourceCo did a competitive bid and picked FacilityMgr (FM) to take over the work and the majority of existing employees
- OutSourceCo & FM developed an agreement that would deliver transformational results – reducing costs and improving service, while allowing FM to grow both their top line revenue and bottom line margins

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Facility Management #2

	Pricing Model Framework				
	Base Business / Service Delivery				Transformational
	Contract Type	Management Fee			Shared Savings
		Base	At Risk	Governance	
Model	Base Book: Cost plus incentives	50% Base Fixed % based on area	50% At Risk • 15% CPIs • 15% KPIs • 20% Discretionary (Happy Factor)	Included in base fee	FM compensated for reducing cost structure beyond scheduled expectations. Incentive fee is evaluated separately . Idea must be pre-approved prior to implementation. Cost sharing is only allowed when relevant parts of the budget are underspent.
	Projects: Cost plus	Structured approach for determining management fee leveraging preferred pricing • Small projects – pre-agreed fee structure /no proposal required • Large projects – proposals with individual fee structure			
Payout	None	Paid Quarterly	Paid Annually Based on Performance	Included in base fee	As results realized Capped at very high level
Percent of Total Provider fee	0%	50%	50%	Included in base fee	Variable

Facility Management #2

Compensation – At-Risk Award Criteria

Critical Performance Indicators (CPIs) 15% of total fee	Uninterrupted Operations (FM fully operated facilities)
	Notices of Violations and Government Fines
	Community Relations & Negative Publicity
Key Performance Indicators (KPIs) 15% of total fee	Annual Facilities Satisfaction Survey
	Moves Satisfaction Survey
	Occupancy Rate and Data Accuracy
	Project Management
	System Reliability
	Cleaning Audit and CFAM Audit
	Health, Safety & Environment Risk Key Element

Facility Management #2

Compensation – At-Risk Award Criteria

DISCRETIONARY 20% of total fee	Overall Cost Management
	Stewardship (Invoice quality, CSAs, Fixed Asset Inventory)
	Organizational Capability & Succession Planning
	Supplier Diversity % (NA only)
	Governance KEA
	Initiatives: Perfect Site, Master Planning, Agile Office, Sustainability, etc.

Note: Criteria may change each year.

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Facility Management #2
Shared Savings

- Eligible amount capped at “very high” $2 million level
- Controllable & Non-Controllable Eligible
  - Evaluated Separately
  - Paid to FM only if that part of budget is under spent!
- Idea must be Pre-Approved before Implemented
- Non-Controllable Expenses:
  - Taxes
  - Insurance
  - Rent/leases
  - Leasing commissions
  - Depreciation and disposal
  - Utility costs

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Quarterly Business Reviews / SRM

Top-to-Top meetings focused on how to improve the relationship and the results

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Not If, But When....

- The Quarterly Business Review (QBR) is fed by weekly meetings
- Information gathered tactically feeds strategic metrics
  - Daily metrics feed weekly
  - Weekly metrics feeds monthly
  - Monthly metrics used in quarterly reviews
- Need to decide with the contractor
  - Where the meeting will be conducted
  - Length of the meeting
  - Who is responsible for developing the agenda
  - Who is to attend each meeting
    - Could vary based on topics / issues to be covered
    - Some annual meeting may involve larger groups

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Data Driven Business Reviews

Use data-driven analysis as the basis for contractor reviews and communications. The goal is to actively manage performance.

- **Performance to Requirements**
  - Ability to meet requirements
  - Analysis of requirements not met
    - Trend against requirements
    - Understanding of trend; Pareto chart, etc. of why not met
    - Root cause identification / solution
    - Action plan / steps taken to improve trend, eliminate cause for not meeting requirement
- **Business Analysis**
  - Identification of business trend
  - Understanding of trend, Pareto chart
  - Business case to improve service or decrease costs
  - Action plan / timeline to improve trend
- **Look Forward**
  - New/changed requirements over the next quarter
  - Future plans

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Joint Scoring of Performance to Measure Perception Gaps

- A well-designed dashboard also allows both parties to rate each other's performance and their own
- A joint approach for scoring performance will highlight gaps in perceived performance
  - Prompt better conversations about why this gap exists
  - Present potential resolutions to close the gaps

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- When Microsoft outsourced its facilities management services to Grubb & Ellis, it used a joint measurement approach where both parties provided a score for the key metrics

Score from individual locations

Client Score

Service Provider Self Score

Service Provider Scorecard								
KPI		Possible score—100	Scores					Comments/examples
			Client				Self score	
			Individual score			Client score		
Category weighting—25%		KPI weight						
1	KPI example 1	20%						
2	KPI example 2	40%						
3	KPI example 3	20%						
4	KPI example 4	20%						

Weighted KPI's

Example of the format used

Results

- Initially, there was a significant gap in expectations and performance as measured by Microsoft versus Grubb & Ellis
- Over the first two years, the gap decreased by 91.5 percent, resulting in tight alignment between the two companies
- In addition, the final performance score improved by 47.6 percent over the same period

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Any Questions Before We Wrap Up?

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